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STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**08/22/05**	Bill No:	**AB 964**
Tax:	**Property**	Author:	**J. Horton**
Related Bills:			

BILL SUMMARY

This bill would:

- Establish an assessment methodology for determining the market value of certificated aircraft owned by commercial air carriers to be used for the next six assessment years. *§401.17*
- Establish a centralized system for commercial air carriers to file one annual property statement each with a designated "lead" county for certificated aircraft as well as other personal property and real property fixtures located at airport locations. *§441*
- Establish a coordinated multi-county audit team to perform mandatory audits of commercial air carriers. §*1153.5*

Summary of Amendments

Since the previous analysis, this bill has been amended to delete a specific reference to embedded software and a definition of term. The amendments also make this bill an urgency statute with an immediate effective date.

ANALYSIS

Current Law

Property Statements. Generally, the valuation of business personal property is based on the acquisition cost of the property. The acquisition cost is multiplied by a price index, an inflation trending factor based on the year of acquisition, to provide an estimate of its reproduction cost new. The reproduction cost new is then multiplied by a percent good factor (from a percent good table) to provide an estimate of the depreciated reproduction cost of the property (reproduction cost new less depreciation). The reproduction cost new less depreciation value becomes the taxable value of the personal property for the fiscal year.

Under existing law, commercial air carriers are required to file property statements for each location in each county in which they own or use real or personal property detailing their property holdings, acquisition costs, and flight and ground data. These statements are the basis for determining the property tax assessment for the upcoming year.

- **Aircraft Fleets.** Certificated aircraft are valued for purposes of property taxation under a "fleet" concept. This means that the basis of the assessed value is not the value of any single aircraft owned by an air carrier, but rather the value of **all** aircraft of each particular fleet type[1] (i.e., all aircraft owned of an identical make and model regardless of age) that is flown into the State. Aircraft fly in and out of the State; no single or particular aircraft remains located in the State on a permanent basis. Under the "fleet" concept, the types of aircraft that have gained situs in California by their entry into revenue service are valued as a fleet and then only an allocated portion of the entire value of the fleet is ultimately taxed to reflect actual presence in California.

- **Types of Aircraft in the Fleet.** Under existing law certificated aircraft must be valued each year at its current fair market value. Existing law is silent as to the method to be used in determining the fair market value of any particular aircraft. However, for assessment years 1998 through 2003, which cover the 1998-99 through 2003-04 fiscal years, Revenue and Taxation Code Section 401.15 detailed a valuation methodology for certificated aircraft, which, if the assessor followed, the resulting value would be presumed to be the fair market value of the aircraft fleet.

Audits. Section 469 of the Revenue and Taxation Code requires assessors to audit once every four years the personal property holdings of any property owner with an assessed value of more than $400,000. These audits are commonly referred to as "mandatory audits."

Proposed Law

Property Statements – Centralized Reporting. Currently, commercial air carriers file property statements for each location in every county that they own or operate personal property. This bill would add subdivision (l) to Section 441 to instead allow commercial air carriers to file a single consolidated property statement with a designated "lead" county. Newly added Section 1153.5 outlines the process for selecting the lead county for each airline, notifiying the airline of the responsible lead county to which it would file its information, and detailing the duties of the lead county (i.e, accept property statement, determine fleet value, transmit unallocated fleet values to other counties for further processing, transmit property statements for non-aircraft personal property assessment to the relevant county, and lead the audit team responsible for the mandatory audit).

Aircraft – Centralized Fleet Valuation. The lead county would calculate the fleet value of the airlines' certificated aircraft for each make, model, and series. This information would then be transmitted to the other counties. Each individual county

[1] Types are grouped by make and model. For example, Boeing 737-300s and 737-500s, Boeing 747-400s; Airbus A300-F4-600S; and McDonnnel Douglas DC 10-30s.

would then determine their allocated portion of the fleet based on the flight data for that particular county.

Other Personal Property - Individual County Assessment. The lead county would also transmit the property statement related to an airport location to the situs county. Each county would be responsible for valuing personal property and fixtures at their particular airport locations.

Valuation Methodology. This bill would add Section 401.17 to the Revenue and Taxation Code to outline a methodology for determining the value of certificated aircraft for property tax purposes. The value would be based upon the lesser of (1) historical cost basis, as specified, or (2) prices listed in the *Airliner Price Guide*, a commercially-prepared value guide for aircraft, and adjusted as specified.

Audits. This bill would add Section 1153.5 to the Revenue and Taxation Code to allow the mandatory audit of a commercial air carrier to be performed by an audit team comprised of staff from one to three counties. The audit would encompass all of the personal property and fixtures of the air carrier located in California. The work performed by the audit team would be made on behalf of each county for which a mandatory audit would otherwise be required under Section 469.

In General

Business Personal Property.

Personal property used in a trade or business is generally taxable, and its cost must be reported annually to the assessor on the business property statement as provided in Revenue and Taxation Code Section 441. Personal property is not subject to the valuation limitations of Proposition 13. It is valued each lien date at current fair market value.

Generally, the valuation of personal property is based on the acquisition cost of the property. The acquisition cost is multiplied by a price index, an inflation trending factor based on the year of acquisition, to provide an estimate of its reproduction cost new. The reproduction cost new is then multiplied by a percent good factor (from a percent good tables) to provide an estimate of the depreciated reproduction cost of the property (reproduction cost new less depreciation). The reproduction cost new less depreciation value becomes the taxable value of the property for the fiscal year.

Certificated Aircraft

Under existing law, all property is taxable unless there is a specific constitutional or statutory exemption for the property. The determination of taxability is generally made as of the lien date, January 1 of each year. Certificated aircraft used by air carriers is subject to taxation when in revenue service in California. Generally, certificated aircraft are commercial aircraft operated by air carriers for passenger or freight service. The term "certificated aircraft" is defined in Revenue and Taxation Code Section 1150 as

> . . . aircraft operated by an air carrier or foreign air carrier engaged in air transportation, as defined in subdivisions (3), (5), (10), and (19) of Section 101 of Title I of the "Federal Aviation Act of 1958" (P.L. 85-726; 72 Stat. 731), while there is in force a certificate or permit issued by the Civil Aeronautics Board of the United States, or its successor, or a certificate or permit issued by the California Public Utilities Commission, or it successor, authorizing such air carrier to engage in such transportation.

Revenue and Taxation Code Section 401.15 (which expired after the January 1, 2003 assessment year) provided a methodology for valuing certificated aircraft and Section 1152 provides an allocation formula to determine the frequency and the amount of time that an air carrier's aircraft makes contact and maintains situs within a county. Property Tax Rule 202 provides further details in the allocation procedure. Under current law, an allocation ratio is made up of two components: a ground and flight time factor, which accounts for 75% of the ratio, and an arrivals-and-departures factor, which accounts for 25% of the ratio. The sum of these two factors yields the allocation ratio, which is applied to the full cash value of a fleet of a particular type of aircraft operated by an air carrier and, thus, the calculation of the assessed value for that type of aircraft. The sum of the assessed allocated values for each make and model used by an air carrier, results in the total assessed value of the aircraft for that air carrier for a particular county.

As noted above, certificated aircraft are valued for purposes of property taxation under a "fleet" concept. An individual air carrier, Blue Sky Airlines, for example, may operate the following types of aircraft in its overall fleet: Boeing 737-300s and 737-500s, Boeing 747-400s, and Boeing 767-200s and 767-300s. Each of these types of aircraft are considered to be a fleet type. Thus, Blue Sky Airlines may have a fleet of 100 Boeing 737-500s, but only 30 of those aircraft may actually make contact in Sacramento County during the year. For purposes of property taxation in Sacramento County, the full cash value of all 100 of Blue Sky Airline's Boeing 737-500 aircraft is determined and the computed allocation ratio is applied to that value.

The Aircraft Advisory Subcommittee of the California Assessors' Association Standards Committee meets several times a year to determine and recommend values for certificated aircraft. The subcommittee has existed since 1965. The subcommittee recommends values for statewide uniformity, but prior to the enactment of Section 401.15, assessors in individual counties were not required by law to use the suggested values. Airline representatives are annually given an opportunity to present market evidence relating to extraordinary obsolescence of specific aircraft types to the Aircraft Subcommittee.

Background

1998 Settlement Agreement. Prior to January 1, 1999, California law did not provide any specific assessment methodology procedure for valuing certificated aircraft or for valuing the carrier's possessory interest in the publicly owned airport. In 1997-98, a group of counties and airline industry representatives met to resolve issues related to the property taxation of property owned and used by airlines which would be embodied in a written settlement agreement to dispose of outstanding litigation and appeals over the valuation of possessory interest assessments in airports and the valuation of certificated aircraft. The settlement agreement was codified in a three-piece legislative package:

AB 1807 (Stats. 1998, Ch. 86; Takasugi)

- outlined the valuation procedures for certificated aircraft for a six year period
- included the monetary portion of the settlement agreement, and
- included extensive uncodified legislative findings and declarations.

AB 2318 (Stats. 1998, Ch. 85; Knox) specified the assessment methodology for valuing the airlines' possessory interests in publicly owned airports.

SB 30 (Stats. 1998, Ch. 87; Kopp) allowed counties and taxpayers to enter into written settlement agreements granting taxpayers tax credits.

In 2003, **SB 593 (**Ackerman) proposed transferring the assessment jurisdiction of this property from county assessors to the Board of Equalization. This bill was held in the Senate Appropriations Committee. In addition, the **California Performance Review Report** recommended in its 2004 report to the Governor, that the Board of Equalization assess aircraft owned by commercial airline.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Air Transport Association (ATA). According to the sponsor, its purpose is to increase efficiency and reduce administrative costs for both the airlines and the government.

2. **Key Amendments.** The **August 22** amendment deletes a specific reference to certain software that is installed in a commercial aircraft. An emerging issue in the assessment of aircraft is a deduction for "embedded software." According to counties, some airlines have sought a 2% to 10% reduction in aircraft values to account for non-taxable software (i.e., a computer program that is not a basic operational program under Section 995 and 995.2), which, to date, has not been granted. There is some disagreement over whether the software installed in the manufacture and outfitting of commercial aircraft that is related to its ordinary, safe and effective operation is “basic operational software” that is fully taxable or whether it should be exempt as non-taxable software. Currently, there is no law or regulation that directly addresses this issue as it applies to aircraft. Some airlines have filed appeals to reduce their assessment by the value of the software in question, but to date have not successfully won an appeal at the local level. As amended July 14, the bill specifically addressed the taxation of this type of software which the August 22 amendment deletes. Thus, absent a specific statute or regulation on this matter as it relates to aircraft, this leaves the taxability of the software programs in question to which the Board, an appeals board, or a court could reach different decisions. The **July 14** amendments add the valuation methodology to be used for the next six

assessment years. The amendments codify an agreement reached between airlines and county assessors relating to the assessment of certificated aircraft and other personal property and fixtures at airport locations that are owned by commercial air carriers. As introduced, the bill would have instead transferred assessment responsibility from the local county assessor to the Board of Equalization. The **June 1** amendment deleted Senator Ackerman as a coauthor. The **May 26** amendment deleted the introduced version of the bill, which would have provided centralized assessment by transferring assessment jurisdiction from each individual county to the state. The amendments instead provided for centralized assessment at the local level by designating a lead county.

3. **The 1998 Settlement Agreement has expired.** The assessment methodology for certificated aircraft codified in 1998 via a settlement agreement between counties and airlines expired after the 2003 assessment year. Commencing with the 2004 assessment year, no assessment methodology has been specified in statute for certificated aircraft.

4. **A delineated valuation methodology for certificated aircraft**. The valuation of aircraft has been a contentious area. This bill would codify a valuation methodology jointly developed and agreed to by the airline industry and a county assessor working group. This bill reflects the legislative portion of the settlement agreement, which once signed would also dispose of pending appeals and future potential lawsuits related to airlines.

5. **Property appraisal is somewhat subjective and opinions of value differ.** As such, this bill will provide certainty and predictability in the valuation of aircraft for both assessors and airlines. Absent a codified methodology, there is no guarantee that the values determined by each individual county assessor would be the same, higher, or lower than they would be without this bill.

6. **The 2005 Settlement Agreement Refines the Valuation Methodology – Applying the lessons learned from the 1998 Settlement Agreement.** This bill essentially builds upon the prior methodology. It recognizes the need to distinguish between different types of aircraft: passenger aircraft (main-line jets or regional jets) and freighter aircraft (production or converted). In addition, it recognizes the need to detail the specific calculation of the variable components that were previously lacking. With respect to calculating a reproduction cost new less depreciation value indicator (i.e., the historical cost basis) each variable component is specified; specifically: (1) acquisition cost, (2) price index, (3) percent good factor, and (4) economic obsolescence. With respect to using the *Airliner Price Guide*, a “blue book” value guide for aircraft, the use of values referenced in that guide is specifically delineated and recognizes that airlines generally receive a fleet discount that is not reflected in prices listed in the guide. Assessors indicate that based on a sample of large and small airlines the new methodology in comparison to the prior methodology, produces values that range from 5% - 15% less. To provide a frame of reference, it is estimated that the assessed value of certificated aircraft alone that is allocated to California totals approximately $10 billion.

7. **The change in the airline industry given the unanticipated events of September 11 proved the need to modify the methodology to better reflect economic obsolescence**. This bill includes legislative intent language explaining the difficulty of measuring economic obsolescence when a major incident such as September 11 occurs. This bill would establish detailed procedures in determining adjustments for economic obsolescence that would better capture significant changes in market values due to severe changes in the industry's economic condition.

8. **Centralized Calculation of the Fleet Value by the lead county would ensure statewide consistency in the base valuation of the fleet.** Airlines have claimed that even though all the counties were using the same assessment methodology during the first settlement agreement period, the fleet value calculated by various counties differed. Counties countered that the value discrepancies could be traced to differences in the information reported by the airlines to the counties or differences that have been discovered via an audit of the company. This bill will ensure a uniform statewide assessment by designating a lead county to calculate the fleet value and ensuring that airlines report the same information to every county. Therefore it should eliminate any discrepancies with aircraft assessment from one county to another and achieve the goal of uniform assessed values for aircraft for any one particular company in each county.

9. **The central assessment of aircraft would result in administrative efficiencies for both airlines and counties.** Commercial airlines must submit duplicative information about their fleet of aircraft to every county for every location in which they operate. Central reporting procedures for the airlines of other personal property to the lead county for subsequent dispersal to the relevant county would similarly reduce the carriers administrative reporting burdens. In addition this bill eliminates duplication of audits.

COST ESTIMATE

This bill would not result in any costs to the Board.

REVENUE ESTIMATE

Section 401.15, originally enacted in 1998, provided a valuation procedure for certificated aircraft for a six-year period. This section was effective for fiscal years 1998-99 through 2003-04. The proposed amendments to this bill would enact a similar valuation procedure amended to reflect the significant changes in the airline industry since the September 11, 2001 incident.

Generally, certificated aircraft are commercial aircraft operated by air carriers for passenger or freight service. Certificated aircraft used by air carriers is subject to taxation when in revenue service in California. Certificated aircraft are personal property and therefore are not subject to the value restrictions of Proposition 13. They are to be assessed each year at fair market value. Since the proposed amendments to Section 401.15 contain a reasonable procedure to arrive at the fair market value of these aircraft, there would be no revenue impact due to this bill.

While it is true that the revenue realized under the proposed valuation method might be different from the revenue derived from the methodology in the original Section 401.15, the change in value is due to the actual change in value of certificated aircraft as determined by market forces. The proposed methodology takes these changes in the industry into consideration.

Revenue Summary

There is no revenue impact from this bill, as the proposed valuation methodology is a reasonable method to determine fair market value of certificated aircraft.

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